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UNCLAS SECTION 01 OF 03 KINGSTON 000832

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SENSITIVE

STATE FOR WHA/CAR/ (WBENT), WHA/EPSC (JSLATTERY)

SANTO DOMINGO FOR FCS AND FAS

TREASURY FOR L LAMONICA

E.O. 12958: NA
TAGS: ECON EFIN JM
SUBJECT: JAMAICA: A NATION SADDLED BY DEBT

REF: 03 KINGSTON 3056

¶1. (U) Summary: Despite GOJ efforts to lower its gargantuan public debt, Jamaica still has the unenviable record of being the second most indebted country in the world, after Lebanon, in terms of its debt-to-GDP ratio. At the end of 2004, Jamaica's stock of public debt stood at USD 12.5 billion or 142 percent of GDP. Most of this debt is owed to private creditors and multilateral and bilateral agencies. Increasing debt has been underpinned by higher borrowing to finance expenditures and the take-over of government guaranteed debt and could have been worse were it not for debt forgiveness. Notwithstanding, the island maintains a well-established record of never defaulting on its debt. Recognizing the gravity of the debt dynamics, the GOJ formulated a medium term debt management strategy in 1998. While the sustainability, management and operation of the debt has improved since then, challenges still abound. Debt servicing now accounts for over 70 percent of the budget, and the GOJ's goal of reducing the debt-to-GDP ratio to 100 percent of GDP by March 2006 appears optimistic. End Summary.

¶2. (SBU) Jamaica's rocky relationship with debt started during the oil crisis of the 1970s, but was aggravated by the financial sector crisis of the mid 1990s and the subsequent GOJ intervention. The financial sector bail-out added over USD 1.7 billion to the debt stock in April ¶2001. By the end of 2004 the debt had jumped to USD 12.5 billion or 142 percent of GDP, making Jamaica the second most indebted country in the world (in terms of the debt-to-GDP ratio) among countries assigned a "B" rating by international credit rating agencies, surpassed only by Lebanon. Courtney Williams, Senior Fiscal Economist of the Ministry of Finance, told emboff on March 8 2005 that Jamaica is also by far the most heavily indebted country in the region. The debt of the GOJ, at nearly five times revenues, is also one of the highest among B-rated countries. Again only Lebanon is worse. Jamaica's fiscal deficit of 5.5 percent in 2004/05, while better than most of its peers, places the country above the three percent or less benchmark target outlined by the Economic Commission for Latin America and the Caribbean (ECLAC) for countries with Jamaica's level of debt.

¶3. (U) All is not lost, however, as the country's debt-to-GDP ratio has started to trend down from its recent peak of just over 150 percent of GDP. Jamaica also runs massive primary surpluses (the difference between revenues and expenditures before debt servicing) to finance its high debt burden. The primary surplus averages nearly 10 percent of GDP, several times the ratio in most B-rated countries and about three times that of Brazil. In addition, the country's external debt service-to-exports ratio averages around 15 percent, well below the 30 percent benchmark. Domestic interest rates are on the decline, the local currency has been stable, and the GOJ has the ability to raise revenues through increased citizen compliance with the tax code. Jamaica also has a well-established record of never defaulting on debt.

¶4. (U) Over USD 1.4 billion was added to the stock of public debt in 2004, a 13.5 percent increase over 2003. While this represents a slowdown in the rate of build-up, the situation would have been worse had it not been for a USD 16.4 million write-off from the British government, bringing to USD 65.6 million the amount written off under the Commonwealth Debt Initiative. The Dutch Government also forgave USD 6.8 million, while the USG swapped USD 6.5 million in exchange for investment in nature through the Tropical Forest Conservation Act (TFCA). Williams told emboff that, while about USD 1 billion of the debt contracted in 2004 was sourced between April and December, only USD 506 million was for budgetary financing. The remaining USD 477 million represented deferred financing (reftel) and brings into sharp focus the negative effects of this practice and, more importantly, government guarantees on loans to entities which, more times than

not, have to be taken over by the GOJ and added to the debt stock.

¶5. (U) In a clear break from trend, the external debt stock accounted for most of the increase in 2004, expanding by almost USD 1 billion or 22.1 percent. Senior manager of the Ministry of Finance debt management team, Pamela McLaren, told emboff on March 9, 2005 that the 2004 increase was an anomaly, since the GOJ actually sourced more loans from the external capital market than initially planned. The more crippling domestic debt rose by USD 400 million, or 7 percent, a marked slowdown in the growth rate (27.6 percent in last five years). It is this overdependence on local debt, and the attendant problem of high interest rates, which prompted the GOJ to divert its attention to the external capital market. This has been paying huge dividends as the GOJ's increased foreign borrowing resulted in a build up in the stock of Net Investment Revenue (NIR) (USD 1.9 billion at end 2004). Reduced reliance on domestic debt combined with a general improvement in the economy also allowed the Bank of Jamaica (BOJ) to reduce interest rates eleven times during 2004, a situation Keith Collister of the Jamaica Chamber of Commerce said is bound to improve the debt dynamics in the future.

¶6. (U) The change in the composition of the public debt portfolio is a central tenet of the GOJ's 1998 medium-term debt management strategy. The program was initially designed to return the debt to sustainable levels while ensuring that borrowing requirements are met at minimum cost. While not nearly sufficient to eliminate the burden, the debt management program has succeeded in diversifying the debt portfolio, thereby reducing risk; facilitating Jamaica's increased access to the international capital markets; and maintaining a mix of fixed-rate and floating-rate debt to minimize interest rate risks. The medium-term debt management program also succeeded in lengthening the maturity profile of the domestic debt, while diversifying the creditor and currency composition of the external debt. When asked about the results of the program, McClaren stated that the ability to tap into the foreign market is one clear indication of its success. She further stated that it is this higher external borrowing, which has allowed domestic rates to fall, thereby further improving local economic conditions.

¶7. (U) Jamaica currently owes most of its local debt to financial institutions and its external debt to multilateral and private creditors. Local Registered Stocks remain the most popular domestic debt instrument, accounting for 49.3 percent, while debentures are next in line with 27 percent. The former are preferred for their longer maturity and competitive interest rates. Jamaica increased its presence in the external debt market during the late 1990s and, by the end of 2004, the external debt had moved to USD 5.1 billion from USD 3.0 billion in 1999. Over the same period there has been an obvious shift in the debt composition, with the share of debt owed to private creditors moving from USD 730 million in 1999 to USD 2.4 billion in 2004. At the same time, debt to multilateral and bilateral creditors has moved from USD 2.9 billion to USD 2.7 billion. Most of this decrease is attributed to the decline in debt to the International Monetary Fund (USD 1 million at end 2004) following the ending of borrowing relations in 1995.

¶8. (U) While the ability to borrow debt from the foreign capital market reduces reliance on the local market and, by extension, eases interest rate pressures, it also carries pitfalls. In particular, government is forced to pursue contractionary fiscal policies. Indeed, the GOJ and, more importantly, Finance Minister Davies learned this lesson, as Jamaica had to avoid the capital market for almost a year following his disclosure of politically motivated fiscal indiscipline in 2002. The shift to external borrowing also carries depreciation risks. Already, the GOJ is feeling the effects of having to find additional US dollars to finance its euro debt (21 percent of total external debt) since the euro started appreciating against the US dollar in 2004.

¶9. (U) Increasing debt and debt servicing costs, which now account for over 70 percent of the budget, are not expected to go away any time soon, given that Parliament has passed a bill enabling the GOJ to borrow up to USD 10.7 billion from the local market. This decision has not gone down well with new leader of the Jamaica Labor Party Bruce Golding, who predicted that debt would reach JMD 1 trillion (USD 16.4 billion) by 2006. He told the Senate that excessive borrowing was imposing a mortgage on future generations. The country could also face some turbulent times in the near future, as the GOJ has recently re-taken control of the beleaguered national airline. The temporary management has already signaled its intention to

raise capital for the troubled airline on a GOJ guarantee. The upward movement in US Treasury rates is also expected to up the rates at which Jamaica can contract new foreign debt. Collister said he recognizes these challenges, but maintains that declining interest rates and the stable currency will stall the race to the JMD 1 trillion mark.

¶10. Comment: While the rate of growth of the debt stock could slow in upcoming years, the country is expected to remain mired in debt for the foreseeable future. This proposition makes the GOJ's target of a debt-to-GDP ratio of 100 percent by 2005/06 highly unlikely, unless the much heralded debt forgiveness plan being discussed by the UK's Tony Blair and Gordon Brown materializes. The target becomes even less realistic when the liabilities of the embattled Air Jamaica, GOJ guarantees and deferred financing are taken into consideration. Even the relatively optimistic Collister was quick to point out that, while things were improving, he found these issues troublesome. This could also explain why one senior member of debt management team stated that the GOJ's position on debt concurred with the recommendations in the IMF report on Jamaica, but quickly pointed out that it did not represent his own views. Without sustained economic growth, lower interest rates and exchange rate stability, combined with the will to make hard decisions, Jamaica will almost surely miss its 2006 debt target and possibly sink deeper into debt. End Comment.

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